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IN THE

Supreme Court of the United States

OCTOBER TERM, 1955

No. [redacted]26

UNITED STATES OF AMERICA, *Petitioner*

v.

ANDERSON, CLAYTON & CO., *Respondent*

On Writ of Certiorari to the United States Court of Claims

BRIEF FOR RESPONDENT

OPINION BELOW

The opinion of the Court of Claims (R. 15-23) is reported at 122 F. Supp. 837.

JURISDICTION

The jurisdictional requisites are adequately stated in the Government Brief.

QUESTION PRESENTED

The question presented is whether Treasury Regulations 111, Sec. 29.22(a)-15 is effective to make every sale of treasury stock a taxable transaction.

REGULATIONS INVOLVED

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

> Sec. 29.22(a)-15. *Acquisition or Disposition by a Corporation of its Own Capital Stock.*—Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.
>
> But if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of the Internal Revenue Code.

STATEMENT OF FACTS

There was little controversy as to the facts before the Court of Claims, and, following the hearing, the parties filed a joint request for findings of fact, which the Commissioner found as requested, and which the Court of Claims followed with minor editorial changes. It is difficult, in fairness, to reduce the statement of facts of the court below; but since in taxpayer's opinion the question before the Court is different from that stated by the Government, its view as to the material facts likewise differs considerably and such facts are, therefore, stated as follows:

Anderson, Clayton & Co. was organized in 1929 to engage in cotton merchandising, a highly complex business dependent primarily on expert, experienced and interested management. Its capitalization, originally $25,842,375 of 6% preferred, and 100,000 shares of stated value $1 no par common, was designed to have the preferred stock represent existing values and so that the common could be used to adjust the participation of the managing officials in future earnings above the contracted return on the outstanding preferred. (R. 23-24)

The 100,000 shares of common stock was issued to existing management in relation to existing experience, position, and responsibility, with the understanding that its distribution would be readjusted among the managerial group as responsibility changed, and that its distribution would be controlled by 75 per cent of the common stock and the corporation. (R. 24)

Restrictions were placed upon the payment of cash dividends on the common stock, but the stockholder was entitled to withdraw at any time and the corpora-

tion, absent agreement on price, was obligated to pay him its value determined on the preceding July 31, plus interest. Purchase by the corporation at such value was automatic upon death of the holder. The stock was all held by a trustee under an agreement between the corporation and all common stockholders embodying such terms and others designed to insure that only active responsible management could own common stock. (R. 24-25)

From time to time as junior officials assumed more responsibility shares of the $1 common stock, after dividends in second preferred restored its value to a dollar, were transferred to them by the two chief managing officials, W. L. Clayton and M. D. Anderson, so that upon his death in 1939 M. D. Anderson held only 18,574 of the 31,000 shares originally issued to him. (R. 26)

At the times of the transactions involved the authorized capital stock consisted of 300,000 shares, par value $100, participating four per cent cumulative first preferred, 75,000 shares, par value $100, four per cent cumulative second preferred, and 102,856 shares of common without nominal or par value. No preemptive rights existed as to common stock which could be issued at the discretion of the Board. (R. 27)

After provision for cumulative preferred dividends the common stock was entitled to prior distribution of a Common Stock Surplus, consisting of the undistributed surplus on July 31, 1938, increased each succeeding year by:

(1) Five Dollars per share on all common stock outstanding; and

(2) Four per cent per annum on the Common Stock Surplus balance.

Any remaining undistributed surplus constituted Participating Stock Surplus, belonging one-half to preferred and one-half to common. (R. 27)

By an instrument executed on April 16, 1943, the agreement between all the holders of common stock and the corporation was revised and continued until August 1, 1953. The instrument provided that the value at which such stock was to be purchased in case of death or withdrawal should be $1 a share plus the proportionate interest of the outstanding stock in the Common Stock Surplus and Participating Surplus determined as of the preceding July 31. (R. 28, R. 75-73)

Upon the death of Mr. Anderson, the taxpayer, in accordance with the agreement, purchased his 18,574 shares at the contract value of July 31, 1938, which with interest, amounted to $50.79 a share, or a total of $943,373.46. The cost over the $1 stated value of 15,539 of these shares was charged to the Surplus Allocated to Common Stock account. (R. 27-28) The remaining 3,035 shares of this particular stock were sold to another company official in accordance with the agreement, based on the July 31, 1939, contract value of $32.27 a share and the net "loss" of $18.52 a share or $56,208.20 was charged directly to the Surplus Allocated to Common Stock account. (R. 28) This stock was not retired but was held as treasury stock. While in the treasury no dividends could be paid on it and it could not be voted. (R. 29) Also 1,000 of these shares were sold in 1941 at $33.62 a share and the $32,620 over stated value was credited to the Surplus Allocated to Common Stock account reflecting a "loss" of $17,170 on these shares. (R. 28)

On December 18, 1943, 6,500 shares of the Common Stock was allocated and sold in accordance with the agreement of April 16, 1943, to certain managing officials at the July 31, 1943, contracted valuation of $112.68 a share. The corporation took the notes of the officials in payment and counsel stipulated that for the purposes of this case the $112.68 might be treated as though it were a cash sales price. (R. 26) Under such notes the purchaser had the right at his option to deliver back the stock in full satisfaction of his note. (R. 78) The amount over the $1 stated value was credited to the Capital Surplus Account. (R. 28)

The common stock bought from shareholders was not cancelled or retired but the shares outstanding less those held in the treasury were used in all financial statements, in the payment of dividends, in arriving at the par share values under the agreement. Treasury stock was not voted at meetings of shareholders nor taken into account in payment of dividends. During the taxable year involved there was no authorized unissued stock. (Finding 25, R. 29)

The stated $1 per share value of the Common Stock, which represented its capital under the laws of Delaware, was nominal and the substantial value of such stock was represented by the Common Stock Surplus and the Participating Surplus which amounted to $111.68 per share as of July 31, 1943, after deduction of the $10 dividend declared on November 30, 1943. (Finding 26, R. 29)

Under the certificate of incorporation, the agreement between the corporation and its common-stock holders and the method of accounting there required and consistently followed, the respective purchases and sales of common stock amounted in substance, in the case of

purchases by the corporation to the withdrawal by the stockholder of earnings accumulated during the period of the ownership of such stock, and in the case of sales by the corporation to new managers to a contribution of capital in an amount equal to accumulated earnings so as to equalize the common equity of all stockholders and the distributions during the ownership of such stock by the executive permitted to buy it.' (Finding 27, R. 29)

The purchase of the 18,574 shares of the common stock from M. D. Anderson in 1939 was in conformity with the plan that the common stock should be held only by and sold only to active management. The purchase by the corporation was not for the purpose of investment or to deal in its common stock as it would the stock of another corporation. Under the stockholders agreement with the corporation such common stock could be sold only to persons and upon such terms as might be agreed upon in writing by the holders of the 75 per cent of the stock held by the trustee. Such stock could not be issued or transferred by the corporation until the stockholder executed acceptance of the agreement.' (Finding 28, R. 29)

The sale of 6,500 shares of the common stock to various junior officials in December 1943, was to adjust the respective holdings in the common stock in accordance with responsibility and to reward managerial performance by the ownership of common stock which would keep cash in the business and compel the executives to acquire the proprietary interest deemed essen-

[1] The Government Brief, page 7, argues that these findings by the Court of Claims, Nos. 27-29 inclusive, are merely conclusions, but certainly to the extent they are conclusions of fact requested and agreed to by the Government in the court below, they are binding upon the parties.

tial, and not for the purpose of dealing in its stock as it would the stock of another corporation.[1] (Finding 29, R. 29-30)

Upon original issuance the corporation received $1 a share for its Common Stock, or $18,574, for the stock repurchased in 1939 from the M. D. Anderson estate. This repurchase of the 18,574 shares of Common Stock on December 15, 1939, at $50.79 a share from the M. D. Anderson estate reduced the assets of the corporation by the amount of $943,373.46. The sale of 3,035 shares to W. L. Anderson on December 22, 1939, at $32.27 a share increased the net assets by $97,939.45, and the sale of 6,500 shares at $112.68 a share on November 30, 1943, increased the assets of the company by the amount of $732,420. (Finding 30, R. 30)

The Commissioner determined that taxpayer realized a taxable long term capital gain of $402,285.00 from the sale of the 6,500 shares and a resulting tax of $100,511.25 was paid, and recovery sought and allowed by the Court of Claims in the instant suit. (R. 30)

SUMMARY OF ARGUMENT

The Court of Claims has determined upon undisputed facts that, considering all the facts and circumstances, taxpayer did not deal in its stock as it might the stock of another corporation, and that under the plain terms of the applicable regulations taxpayer realized no taxable gain from the sale of its treasury common stock to management.

The decision of this Court in *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U.S. 110, established that whether an increment to assets from a sale of treasury

[1] For footnote, see p. 7.

stock is income is at least a debatable question, and that the administrative construction excluding it had acquired the force of law through repeated Congressional reenactment of Section 22.

The revised regulation, Sec. 29.22(a)-15 of Regulations 111, is specific as to the exclusion of original issues of stock and as to the inclusion of stock received as consideration upon the sale of property or in satisfaction of indebtedness, but insofar as applicable to the instant transaction provided that the question hinged upon the real nature of the transaction to be ascertained from all its facts and circumstances, and whether the corporation deals in its own shares as it might the shares of another corporation. The language used shows no clear intent to change, nor is it sufficient to effect a change, in the law as determined in *Helvering* v. *R. J. Reynolds*, *supra*. Clear, unambiguous language is as necessary to bring a transaction within a taxing regulation, as within a tax statute, and the taxpayer must be given the benefit of any doubt or uncertainty as to whether the transaction is covered. Congress expressly confirmed the *Reynolds* case rule in Section 1032, Internal Revenue Code of 1954, in order to remove the "uncertainties of existing law" which arose with the recent series of Tax Court and Court of Appeals decisions.

No aspect of the transaction involved resembled dealing in its own stock as taxpayer might in the stock of another company. The stock was in the treasury as a result of the 1939 death of an important managing official and the automatic payment to him of its contractual value based on the earnings and profits during his tenure. It was allocated and sold in December, 1943, to readjust the share of certain other officials in

earnings, and for a price calculated to equalize its position with that of the outstanding common. The stock involved was no par common with a nominal $1 stated value, created and distributed to effect a fair adjustment of corporate earnings above a return on capital. The stock was never purchased for investment, nor with any view to a profit from its resale. While it was in the treasury every right such share embodied when outstanding disappeared.

It is doubtful whether a purchase or sale of its own stock by a corporation can be anything but a capital transaction. Since a share of stock represents a group of contractual rights against the corporation, its acquisition effectively terminates those rights, for a person can scarcely be liable to itself. Recognized accounting principles require the elimination of treasury stock from assets, and the inclusion of any amount received from its reissuance in capital. In formulating rules designed to protect investors the Securities & Exchange Commission requires that all transactions in treasury stock be treated as capital in nature. In the field of national banks Congress has recognized and this Court affirmed that the purchase of its stock retires capital and its resale restores it. From every commercial viewpoint that is what occurred here.

The decisions of the Courts of Appeal relied upon by the Government ignore the plain terms of the regulations and as the Court of Claims points out are based entirely on the failure of the taxpayer to go through the formal mechanics of actually retiring the stock and issuing new shares when the occasion to do so should arise.

Under Delaware law and the provisions of taxpayer's Certificate of Incorporation the only distinction be-

tween treasury stock and unissued stock was formal. Either as treasury shares or newly issued shares the no-par common could be sold at any price, not involving fraud, determined by the Directors. No preemptive rights existed. Both the Delaware law and the corporate charter authorized the reissuance of any shares formally retired. Every significant right represented by a share disappeared in the treasury and for every practical business purpose it was valueless and meaningless.

Contrary to the controlling importance the Government seeks to give the fact that the treasury shares rather than newly issued shares were involved here, it attaches no significance to this question in other tax fields. It recognizes that a dividend in treasury stock is a non-taxable dividend. It taxes stockholders with the proceeds of stock redeemed and held in the treasury, and it has required the elimination from invested capital of an amount paid for treasury stock unless it is held for investment. In each of these fields the courts have refused to recognize that treasury stock is property, or that its purchase or sale left the capital of the corporation unaffected.

From the undisputed facts the Court of Claims determined that the 1943 transaction of the taxpayer in its stock was not brought within the terms of Section 22 taxable income by the applicable regulation.

ARGUMENT

The Applicable Treasury Regulations Are Ineffective to Reverse Preexisting Rules Embodied in Law That Transactions by a Corporation in Its Stock Like That Involved Here Were Capital in Nature

Here, as in *Eisner* v. *Macomber*, 252 U.S. 189, the problem is one of "distinguishing gain from capital". *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426. "Whether the increment is income is at least a debatable question", and an interpretative regulation is appropriate. *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U.S. 110, 114.

The regulation applicable there provided plainly enough that:

> "If * * * the corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation. A corporation realizes no gain or loss from the purchase or sale of its own stock."

As the Court of Claims said here:

> "This rule was reasonable, logical and in accord with the accountants' view." (R. 19)

In May 1934 after the Court of Appeals for the First Circuit held in *Commissioner* v. *S. A. Woods Machine Co.*,[2] (1932) 57 F. (2d) 635, that a corporation realized

[2] Except on the ground that what was really involved was a collection of indebtedness and not a purchase of its stock the result in this *Woods* case ignores entirely the regulation held controlling by this Court in *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U.S. 110. There has been and is no controversy regarding the realization of taxable income from such transactions as to which the new regulations were quite specific. (Government Brief, p. 25, footnote 16.)

gain when it received its own stock which it immediately retired, in settlement of patent infringement damages, the Commissioner rewrote the regulation to read that:

> "Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.
>
> "But if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of the Internal Revenue Code."

In *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U.S. 110, 115 this Court definitely held that:

> "* * * Under the established rule Congress must be taken to have approved the administrative construction and thereby to have given it the force of law."

Since Congress had thus excluded transactions of this sort from the tax, definite action by Congress or by authorized regulation is surely necessary to bring such transactions within the tax. Inclusion in gross income, not exemption, is involved.

Assuming, as this Court refused to decide in the *Reynolds* case, that the Treasury could change for the future a rule which had become incorporated in the law,[3] the burden is surely upon the Treasury to show that it did so. If its action is not clear, then its regulation, as much as a statute itself, is in case of doubt to be "construed most strongly against the government, and in favor of the citizen." *Gould* v. *Gould*, 245 U.S. 151.

While this new regulation abandoned the simple positive rule that a corporation realized no gain or loss from purchase or sale of its own stock, it is specific only in excluding receipt by the corporation of subscription to original issues and in including receipt of stock as consideration upon the sale of property or in satisfaction of indebtedness. Otherwise and insofar as it is pertinent here the only guidance available to taxpayers in 1943 in determining whether the previously applicable rule had been reversed is found in these sentences:

> "* * * * Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. * * *

[3] In *Helvering* v. *Wilshire Oil Co.*, 308 U.S. 90, the Court upheld Treasury authority to change a legislatively approved rule by definite exercise of its continuing rule-making power. There was no ambiguity in, or doubt as to, the meaning of the regulation there.

"But if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. * * * "

The Government's position basically is that this language is window-dressing,—to be ignored,—and that the regulation really means that no sale of its stock by a corporation is a capital transaction except on original issuance. That language would have been simple and readily understandable. But the Treasury chose deliberately to state its administrative rule in the general and uncertain terms quoted, imposing upon tax tribunals the responsibility of exploring the real nature of the transaction considering all the facts and circumstances and deciding then whether the corporation had dealt in its stock as it would the stock of another corporation. Had the Treasury clearly intended to include all sales of treasury stock in taxable transactions, it could readily have done so.[4]

[4] Regulations 33, Art. 98, issued under the Revenue Act of 1916, but reversed in Regulations 45, Article 542, provided:

"Reg. 33 (Rev.), Art. 98, 362 and 363. Treasury stock—When taxable.—Treasury stock, whatever and whenever that term is used in connection with the accounts of the corporation or for income-tax purposes, will be held to mean stock which had been previously issued by the corporation and which had been repossessed by it through purchase or otherwise and then carried on its books as an asset. If such stock is resold at a price in excess of its cost upon repossession, such excess shall be returned as income for the year in which resold. Unissued stock, which had been retained by the corporation for the purpose of future sale, will not, for the purpose of the income tax, be considered 'Treasury stock,' and when sold no part of the proceeds of such sale will be considered taxable income. Nor will there be any deductible loss if such stock is sold at a price less than par."

Assuming the authority of the Treasury to change a rule which this Court held has congressional approval and the force of law, this ambiguous, general language is scarcely a proper or effective method of changing the law. It is significant that upon its first consideration of this subject after the new regulation was issued Congress expressly enacted the "reasonable, logical" rule of the earlier regulations, for the purpose, according to the tax committees, of removing "the uncertainties of present law." (Section 1032, Internal Revenue Code of 1954, House Report 1337, 83rd Congress, Second Session, Page A 268; Senate Report No. 1622, 83rd Congress, Second Session, page 426) This action, the first consideration of Congress after the changed treasury regulations, indicates that the government interpretation of the Treasury Regulations misinterprets Congressional intention. *Jackson* v. *Commissioner*, 172 F. (2d) 605, p. 607.

The Court of Claims Finding That the Taxpayer Did Not Deal in Its Own Shares as It Might the Shares of Another Corporation Is Supported by the Undisputed Facts

Proper application of the interpretative principles applicable to a tax imposing law or regulation would seem to require that the facts bring the transaction clearly within the terms of the law or regulation. Unless, therefore, taxpayer *dealt in*[5] its own shares as

[5] The words "deal in" involve the purchase and sale of goods for the purpose of gain. As early as *Fleckner* v. *The Bank of the United States*, 21 U.S. 338, 351, the Court had before it the question whether the Bank had, contrary to law, engaged in "dealing or trading in" promissory notes. It said:

> "The true interpretations, however, of that rule is, not that it prohibits purchases generally, but that it prohibits buying

it might the shares of another corporation, the Treasury Regulation does not bring the transaction within the scope of the tax.

It is difficult to imagine a transaction less like dealing in the shares of another corporation than that involved here.

The whole arrangement, created by the certificate of incorporation, the agreement between the corporation and all the common stockholders, and the understanding among such stockholders, contemplated that the common stock would be used only to adjust the participation of active managing officials in earnings above a specified return on capital. (R. 23-24)

The automatic acquisition of the 18,574 shares from the M. D. Anderson estate in 1939 was pursuant to the agreement and plan (R. 29), and amounted in substance to the withdrawal by the Anderson estate of earnings accumulated during his period of ownership. (Finding 27, R. 29) The purchase was not for the purpose of investment or to deal in its common stock as it would the stock of another corporation. (Finding 28, R. 29)

And when in December, 1943, it was decided by the corporation and the common stockholders that an ad-

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and selling for the purposes of gain. It aims to interdict the bank from doing the ordinary business of a trader or merchant, in buying and selling goods, etc., for profit, and uses the words 'deal' and 'trade' in contradistinction to purchases made for the accommodation or use of the bank, or resulting from its ordinary banking operations."

In determining whether a taxpayer was a dealer in securities both the Treasury and the Court regarded it as important that the taxpayer should have bought or sold the securities with a view to the gains and profits to be derived therefrom. *Helvering* v. *Fried*, 299 U.S. 175.

justment of the share in earnings of certain junior officials was justified, 6,500 shares were allocated to them, And the price fixed for payment, i.e. $112.68 (R. 26), amounted in substance to a contribution of capital in an amount equal to accumulated earnings so as to equalize the common equity of all stockholders and the distribution during the ownership of such stock by the executive permitted to buy it. (Finding 27, R. 29)

While it was held as treasury stock, every effective right a share represents disappeared. It had no vote, was entitled to no distributions, could not be counted for quorum purposes, and was not even effective to increase the annual addition to the Common Stock Surplus. (R. 29, R. 27)

Against these admitted facts, found by the Court of Claims upon the joint request of the parties, the Government has only the fact that the corporation did not formally retire the shares when they were purchased. (R. 29)

None of the usual indicia of dealing in the stock was present. Its utilization was definitely limited. No purchase was made with a view to reselling at a profit. No continuing purpose or intent to resell existed, and some continued to remain in the treasury. (R. 43) It was bought in accordance with the corporation's stockholders contract, and independently sold when a readjustment of the share in earnings of junior management became in order.

The Court of Claims determined that taxpayer did not deal in its stock as it might the stock of another corporation and its determination is adequately supported by the undisputed facts embodied in its agreed

findings. *United States* v. *Yellow Cab Co.*, 338 U.S. 338; *United States* v. *U. S. Gypsum Co.*, 333 U.S. 364; *Niles Bement Pond* v. *United States*, 281 U.S. 357; *United States* v. *Esmault-Pelterie*, 299 U.S. 201.

The Need for Careful Consideration of All the Facts and Circumstances by the Appropriate Tribunal Is Clear from the Doubt Whether a Corporation's Purchase and Sale of Its Own Stock Can Be Anything But a Capital Transaction

While the Court below determined that the taxpayer was entitled to recover under the plain terms of the regulations, it stated its doubt as to whether a purchase and sale of its own stock by a corporation could be anything but a capital transaction. That position is strongly supported by basic corporate legal theory and by recognized accounting and business principles.

Corporate theory scarcely permits the acquisition or disposition by a corporation of its own stock to be treated as anything but capital transactions. As an artificial being,[6] existing only in contemplation of law, whose creature it is, the nature of the corporation and its relations with its shareholders have demanded considerable attention from the courts.

Since the Dartmouth College case the charter of a corporation has been regarded as a contract between the corporation and the state and between the corporation and its stockholders. *Lawson* v. *Household Finance Corp.*, 17 Del. Ch. 343, 352. In *Morris et al.* v. *American Public Utilities Co.*, 14 Del. Ch. 136, the Court said:

> "That a corporate charter is a contract has long been settled. In *Gavez* v. *St. Joe Mining Co.*, 32

[6] *The Trustees of Dartmouth College* v. *Woodward*, 4 Wheat 518.

> Utah 497, 513, 91 Pac. 369, 374 (12 L.R.A. (N.S.) 554), it is spoken of as 'a dual contract—one between the state and the corporation and its stockholders, the other between the corporation and its stockholders.' That there is a third aspect in which the contract may be regarded would appear clear, for not only is there a contractual tie binding in the two respects observed by the Utah Court but there is as well a contractual relation in many particulars existing between the stockholders *inter sese*.[7]

If the stockholder-corporation relationship is one of contract, as is clearly the case, then when the corporation acquires a share, the contract must, in logic, either be terminated, or a single person becomes a party to a contract with itself, whereas the most fundamental contract rules require at least two parties. As Circuit Judge Learned Hand said concerning treasury stock in *Borg* v. *International Silver Co.*, 11 F. (2d) 147, 150:

> "A corporation can have no right of action against itself, as must be if the share is truly a liability.
>
> * * * *
>
> "To carry the shares as a liability, and as an asset at cost, is certainly a fiction however admirable. They are not a liability and on dissolution could not be so treated, because the obligor and the obligee are one."

Both state corporation statutes and the courts have been pretty realistic about the real effect of a purchase of its own stock as a diminution of the assets of the

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[7] In the instant case the taxpayer and its common stockholders, through the managerial stock trust agreement, extended considerably the contractual relations established in the certificate of incorporation.

corporation. Some states forbid such purchases altogether, and in Delaware a corporation may use only its surplus to purchase shares of its own capital stock. As the Court stated in *In Re International Radiator Co.*, 10 Del. Ch. 358:

> "In other words, a corporation may use only its surplus for the purchase of shares of its own capital stock. 'Capital' does not in this connection, mean the assets of the company, for, of course, the assets are reduced when any of it is used by a corporation to purchase shares of its own capital stock."

The Government admits (Government Brief, page 18) that, under the accounting treatment customarily accorded dealings in treasury stock no gain or loss is entered and such stock is not carried as an asset on the balance sheet. While accounting principles are not legally controlling, yet it must be considered that they represent the expert judgment of a profession devoted to effective portrayal of the actual results of transactions and the real condition of business enterprises. This customary accounting treatment, moreover, has been followed and prescribed by the Securities and Exchange Commission. The Commission has been entrusted by Congress with the duty of seeing to it that issuers of securities make full and fair disclosure of facts and, in pursuance of that objective, is given authority to prescribe accounting rules and methods. Securities Act of 1933, Title I, Section 19, Title 15 USCA, Section 770.

Pursuant to that authority it issued its Accounting Series Release No. 6, of May 10, 1938, as follows:

> "Under the laws of most states there are certain legal restraints upon the issuance of new shares

that do not apply to the sale of treasury shares. However, from an accounting standpoint, there appears to be no significant difference in the final effect upon the company between (1) the reacquisition and resale of a company's own common stock and (2) the reacquisition and retirement of such stock together with the subsequent issuance of stock of the same class.

"It is recognized that when capital stock is reacquired and retired any surplus arising therefrom is capital and should be accounted for as such and that the full proceeds of any subsequent issue should also be treated as capital. Transactions of this nature do not result in corporate profits or in earned surplus. There would seem to be no logical reason why surplus arising from the reacquisition of the company's capital stock and its subsequent resale should not also be treated as capital."

Surely the judgment of the Commission with regard to the real nature of transactions by a company in its own stock is entitled to considerable respect.

Congress itself had no difficulty recognizing within its own legislative sphere that the purchase of its own stock by a national bank effected a withdrawal of the capital of the association. R.S. Sec. 5201, Title 12, USCA Sec. 83. This Court has recognized that the object and policy of this section is to prevent the reduction of the outstanding stock and the withdrawal *pro tanto* of the capital. *Hood* v. *Wallace*, 182 U.S. 555; *Deitrick* v. *Greaney*, 309 U.S. 697. And in *Lantry* v. *Wallace*, 182 U.S. 536, 553, it quoted with apparent approval the statement of the lower court that:

"'The sale of the stock to the defendant after the bank had purchased the same was not unlawful, since it operated to restore that part of the capital

that had been retired, and to that extent repaired the wrong which might otherwise have been done to the bank's creditors.' 38 C.C.A. 510, 514, 97 Fed. 865, 868."

The difficulty in logic[illegible]pplying usual rules to transactions in capital stock [illegible] apparent from the facts here. The corporation issued 18,574 shares of common stock to M. D. Anderson for $1 a share. Upon his death it paid his estate $943,373.46 or $50.79 a share to recover this stock. (R. 30)

Unless it is treated as a capital transaction it can be argued logically that this purchase of its stock cancelling as it does its previously outstanding contract, represents a closed transaction, and the proper time for computation of any profit or loss is upon the termination of that contract.[8] On the repurchase of the 18,574 shares, therefore, the taxpayer suffered a loss of $934,799.46.

A new contract was entered into when the corporation sold 3,035 shares to W. L. Anderson on December 22, 1939, at $32.27 a share, and the net assets were increased by the entire $97,939.43 paid in. (R. 30) The sale of another 6,500 shares to other managing officials at $112.68 a share increased the assets by $732,420. (R. 30) These contracts were still open and outstanding during the period involved here and would not result in closed transactions until they closed out.

Certainly, if these were debentures this method of determining when a transaction was closed would be

[8] Except upon such a theory the reasoning of *United States* v. *Kirby Lumber Company*, 284 U.S. 1, is inapplicable, and, upon such theory, taxpayer incurred a loss, or, if the differing nature of the stock contract is considered, realized neither gain nor loss.

followed, and to the extent a corporation can be separated from its shareholders the same analysis seems pertinent. When the 6,500 shares were issued to the managing officials, the corporation had simply assumed that much additional liability to them. As a matter of fact, in this particular case the liability was somewhat more than that usually incident to the stockholder-corporation relationship. The corporation was obligated at the option of the holder, to buy back the stock at its latest valuation (R. 28), and to take it back at any time in payment of the note of the purchaser. (R. 78.)

From the point of view of the stockholders prior to the transaction, too, it is difficult to see how their position was improved by the sale of the 6,500 shares for their equivalent value of $112.68, since that price was designed to place the new shareholders in exactly the same position as the old. (Findings 26 and 27, R. 29)

The Decisions of the Courts of Appeal Cited by the Government Ignore the Plain Terms of the Applicable Regulations and Rest Entirely on the Failure of the Taxpayers to Go Through the Formal Mechanics of Actually Retiring the Stock and Issuing New Stock

The Government places its principal reliance upon four decisions of the Courts of Appeal, reversing the Tax Court, which had uniformly refused to hold that the Treasury regulations made taxable a sale of treasury shares "for the purpose of satisfying contractual obligations, equalizing shareholdings, eliminating a participant wishing to retire, implementing an employee profit sharing plan, or keeping the ownership of the corporation within a particular group". (R. 21)

These Courts of Appeal decisions built up on each other like a house of cards. In *Commissioner v. Batten; Barton, Durstine & Osborn, Inc.*, (1948) 171 F. (2d) 474, there were three opinions. Circuit Judge Chase thought that any sale of treasury stock by a corporation constituted dealing in its own stock under the regulations. Circuit Judge Frank concurred on authority of *Aviation Capital v. Pedrick*, (1945) 148 F. (2d) 165, though he thought "it irrational ever to consider 'treasury stock' as a capital asset in these tax cases," and stated that the situation was to his mind like that in a farce:

> "An untenable premise, once adopted, is to be carried out logically."

Circuit Judge Swan dissented on the ground that he agreed with the Tax Court that the taxpayer did not deal in its own shares as it would the shares of another corporation.

Its reasons were stated by the Tax Court in the *Batten* case, 9 T.C. 448, as follows:

> "We sum up our reasons for thinking that petitioner was not dealing in its own shares 'as it might in the shares of another corporation' as follows:
>
> "All sales were made on terms that permitted the employee to turn back his shares which were not paid for and were held by petitioner as collateral, at his purchase price at any time within seven years. No business corporation would deal in the shares of another corporation in that manner as a general method of doing business. In our opinion no business corporation dealing in shares of another corporation would invariably commit itself to repurchase, at book value, the holdings of each and every purchaser upon

> the death, resignation or retirement of that purchaser. Yet that is what the taxpayer did in the case at bar. This followed from the fact that all outstanding shares are held subject to the stockholder's agreement. It is stipulated that during the taxable years in question "all purchases and sales were made at book value"; there was no negotiation as to price. The taxpayer did not carry its treasury stock on its books as an asset. The taxpayer did not attempt to choose a time favorable to it for the purchase or sale of shares. For these and other reasons, we do not think petitioner was dealing in its own shares of stock "as it might in the shares of another corporation." ' "

Upon the authority of the decision in *Commissioner v. Batten, Barton, Durstine & Osborn, Inc.*, (1948) 171 F. (2d) 474, the Court of Appeals for the Seventh Circuit reversed the Tax Court in *Commissioner v. Rollins Burdick Hunter Co.*, (1949) 174 F. (2d) 698, with Chief Judge Major dissenting on the ground that the "undisputed facts clearly demonstrate that the taxpayer did not deal in its own shares as it might in the shares of another corporation".

Those facts were summarized by the Tax Court in the *Rollins* case, 9 T.C. 169, 170, as follows:

> "The stipulated facts amply demonstrate that the petitioner was not dealing in its own shares as it might in the shares of another corporation. The price at which the petitioner should acquire any shares was fixed in advance by agreement. The petitioner had no profit motive in buying or selling, but was merely arranging that its shares should be held, and held only, by those who were its officers and principally responsible, through their personal services, for its success and should be held by them in proportion to their relative abilities

to contribute personal services of value to the petitioner. Those purposes could not be accomplished by dealing in any other stock. The petitioner did not buy stock and sell it to create employee interest. It bought, as was required by agreement, so that the stock would never get into outside hands, but would be used only to indicate ownership in the business by those principally responsible for its success. The purchases and sales readjusted the capital for this purpose only. The transaction, viewed as a whole, was not one giving rise to taxable gain under Section 22(a) and the regulations."

The Court of Appeals for the Third Circuit was next, its decision in *Commissioner* v. *H. W. Porter & Co.*, (1951) 187 F. (2d) 939, relying upon the decisions in *Commissioner* v. *Batten, Barton, Durstine & Osborn, Inc.*, 171 F. (2d) 474, and *Commissioner* v. *Rollins Burdick Hunter Co.*, 174 F. (2d) 698. The Tax Court, 14 T.C. 307, had stated its reasons for refusing to follow the Courts of Appeals as follows:

"In applying the principle this Court has deemed such dealings, when not carried out for the purpose of a prospective profit, but to satisfy a contractual obligation, equalize shareholdings, *Dr. Pepper Bottling Co. of Mississippi*, 1 T.C. 80, eliminate a participant wishing to retire, *Brockman Oil Well Cementing Co.*, 2 T.C. 168, or implement a profit-sharing plan for employees, *Cluett, Peabody & Co.*, 3 T.C. 169, as not dealings which the corporation might carry out in the shares of another corporation, and has held the resulting profit on disposition nontaxable. On facts substantially similar to those here established, we applied the same reasoning and reached the same conclusion in *Rollins Burdick Hunter Co.*, 9 T.C. 169 and in *Batten, Barton, Durstine & Osborn, Inc.*, 9 T.C. 448. The former decision was re-

versed by the Court of Appeals for the Seventh Circuit, 174 Fed. (2d) 698, and the latter by the Second Circuit, 171 Fed. (2d) 474. We are not unmindful of these reversals of our holdings, but we note that in each case the opinion of the Court of Appeals was by a divided court. Moreover, after a careful consideration of the facts and the question here involved, a question which we have a number of times considered over a period of years, we are respectfully constrained to follow our holdings in these and the other cases mentioned above for the reasons therein stated. We have reached the conclusion that petitioner here was not dealing in its own shares 'as it might in the shares of another corporation,' and we accordingly reverse respondent's determination of a taxable gain of $11,800 on petitioner's disposition of the 236 shares in 1943."

And finally in *Commissioner* v. *Landers Corp.*,[9] (1954) 210 F. (2d) 188, the Court of Appeals for the Sixth Circuit followed the three decisions just cited, regarding as immaterial the following facts stated by the Tax Court at 11 T.C.M. 577:

"The record clearly shows that the petitioner never purchased its own shares except as an accommodation upon solicitation of the seller, never purchased them as an investment, never purchased them for the purpose of realizing a profit, cancelled them, treated them as retired, did not intend to resell them when it acquired them, and only resold them for reasons which developed later. The sale of 10 shares to a new director accom-

[9] Directly contrary to the opinion of the Court in *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U.S. 110, this Court of Appeals seems to think that no binding effect could be given a regulation excluding gain on treasury stock sales from taxable income. It seems also to give the dictum in *S. A. Woods Machine Co.*, 57 Fed. (2d) 635, authority much beyond its proper scope.

plished a purpose which could not have been accomplished by the sale of shares of another corporation. The sale of the remaining shares was to raise additional capital for expansion and refitting. The petitioner did not deal in its own shares as it might have dealt in the shares of another corporation. The petitioner realized no taxable gain from the sales of its own shares in 1946."

The Government also refers to the fact that in *Burrus Mills* v. *Commissioner*, 22 T.C. 881, filed July 14, 1954, (On Appeal, Fifth Circuit), the day after the decision in the pending case, the Tax Court changed its position. It did, stating:

"We decide the issue for respondent following the Courts of Appeals decisions cited above."

In the language of Circuit Judge Frank:[10]

"An untenable premise once adopted, is to be carried out logically."

Taxpayer cannot summarize the basic untenable premises on which these decisions of the Courts of Appeals are based in language as plain and compelling as that of the Court of Claims. (R. 22-23)

There Is No Significant Distinction Between Unissued and Treasury No Par Common Stock. But at the Most Such Trivial Formal Difference Was Properly Considered by the Court Below as One Factor Among All Other Facts and Circumstances

The Court of Claims determined that under the particular facts of this case any distinction between treasury stock and unissued stock was one of form.

[10] *Commissioner* v. *Batten, Barton, Durstine & Osborn, Inc.*, 171 F. (2d) 474, 477.

The Government strives continuously to get away from the particular facts here to generalities. The stock involved is no par stock, expressly excepted from any preemptive rights, and Delaware decisions cited in the attempt to develop some difference of substance between treasury and unissued shares (Government Brief, page 42) are inapplicable. Just as in the case of treasury stock Directors may fix the consideration for unissued no par stock at any amount they choose, and in the absence of actual or constructive fraud, the courts will not interfere. *Bodell et al. v. General Gas & Electric Corp.*, 15 Del. Ch. 119, 129, 427.

Contrary to the Government's argument (Government Brief, p. 43) no feature of Delaware law would have prevented taxpayer from retiring the 18,574 shares of common stock in 1939 when it was acquired from Anderson, and reissuing it to Whittington and others in 1943. While the Delaware courts in *Starring v. American H & F Corp.*, 21 Del. Ch. 380, 389, affirmed 21 Del. Ch. 431,[11] disapproved as discriminatory and unfair a corporate plan to retire all its common stock and to reissue it immediately to some stockholders but to eliminate others, the Delaware law contemplates and permits the reissuance of stock previously retired. It expressly provides that "the shares so retired * * * shall * * * if the certificate of incorporation does not prohibit the reissue thereof, have the status of authorized and unissued shares of the class of stock to which such shares belong". Section 28, General Corporation Law, now Section 244, Title 8, Delaware Code of 1953. The corporate charter here specifically authorized such reissue. (R. 54)

[11] The Delaware court also questioned whether a corporation could retire common stock when there is no asset value attributable to it.

In accordance with the obligation of its agreement taxpayer purchased the 18,574 shares owned by M. D. Anderson at the date of his death in 1939, and the present transaction did not occur until December 18, 1943. (R. 43) Clearly, taxpayer might have retired the shares purchased in 1939, reducing its outstanding capital by $18,574 to $32,769,582, but such action could scarcely have been regarded as anything but a silly formality, both because other charter and contractual provisions accomplished the same substantial effect, and because the amount involved was inconsequential.

And equally clearly, taxpayer would have been entirely free insofar as the Certificate of Incorporation is concerned, to sell these unissued shares at any price the directors determined. The same standard of reasonableness and fairness would have applied whether the shares sold were unissued or treasury shares.

The Government seems to argue (Government Brief, p. 43) that it would "exalt form above substance" to attach any importance to whether the taxpayer went through "the motions of retiring the reacquired shares and replacing them with an equivalent number of new ones." The Court of Claims thought so, too, in its consideration of all the facts and circumstances, and found the formal difference insufficient to support the Government's position.[12]

Every significant right represented by the stock disappeared in the corporate treasury. It could not

[12] In this apparently unintentional agreement with the Court of Claims the Government overlooks the express provision of its own Regulation that:

> "The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss * * *."

share in distribution of dividends or of assets upon liquidation. It was excluded from consideration in calculation of the Common Stock Surplus. (Finding 16, R. 27) No voting right existed. As the Delaware Chancery Court said in *Allenberg* v. *Consolidated Copper Mining Corporation*, 20 A. (2d) 743:

> "The treasury shares could not be voted, for Section 19 of The Delaware Corporation Law provides that '* * * shares of its own capital stock belonging to the corporation shall not be voted upon directly or indirectly * * *.' Consequently, it would seem wholly unreasonable to count them in computing a quorum. As between the stockholders and the corporation, treasury stock, which represents no effective obligation against the corporation, is not 'outstanding'. *Borg* v. *International Silver Co.*, 2 Cir., 11 F. (2d) 147; *Scheind* v. *Otis Hatcher Co., et al.*, 204 Ky. 289, 264 S.W. 755. The expression 'outstanding capital stock' as used in the bylaw should be construed to mean stock in the hands of shareholders, not stock in the treasury."

The difference between treasury and unissued shares is not regarded as significant at other points in tax law.

The question of whether any importance is to be attached to the use of treasury rather than newly issued stock has arisen in several other connections. A dividend in treasury stock is a non-taxable stock dividend. The proceeds of stock redeemed and held in the treasury can be equivalent to a cash dividend. The amount paid out for treasury stock must be eliminated from invested capital for excess profits tax purposes.

(a) Dividends in treasury stock

Though *IT 2449*, VIII-1 C.B. 101, previously ruled that dividends in treasury stock constituted exempt stock dividends, the Treasury attempted in its Regulations under the 1936 Act to place treasury stock in a different category from unissued stock for stock dividend purposes. It provided that dividends paid in property were taxable, defined property to include shares of capital stock of the corporation if held as an investment, and provided that shares once issued but later reacquired in any manner but not retired should be deemed to be held as an investment.

In *Bruckheimer* v. *Commissioner*, (1942) 46 B.T.A. 234, the Tax Court held that it made no difference that the stock which was distributed was treasury stock. It said:

> "The argument of respondent is based largely upon an assumption that the reacquired stock was an asset, property, of the corporation. That assumption appears to be against the weight of authority. Treasury stock is usually regarded as 'retired' in the sense that it no longer constitutes a liability of the corporation because a corporation can have no right of action against itself. See *Borg* v. *International Silver Co.*, 11 Fed. (2d) 147, 150, where it was said by the Circuit Court of Appeals for the Second Circuit:
>
> > " 'Indeed, the only difference between a share held in the treasury and one retired is that the first may be resold for what it will fetch on the market, while the second has disappeared altogether. * * * They (Treasury stock) are not a present asset, because, as they stand, the defendant (the corporation) cannot collect upon them. What in fact they are is an opportunity to

acquire new assets for the corporate Treasury by creating new obligations.'

Most authorities lead to the view that treasury stock is not stock at all. See Virginia Law Review, vol. 15, pp. 637, 638, where it is said:

> '* * * Whenever a corporation gives *anything* for its own stock, the corporation is out an asset. Against that it has left only the possibility that some day, under some circumstances, it may succeed in getting value back into the treasury to replace the value it has lost, by the process of again selling this 'treasury stock' which meanwhile, in actual truth, represents a void.'

See also Model Corporation Act, Harvard Law Review, vol. 48, p. 1373: 'Treasury shares shall not be considered or carried as an asset for any purpose.'

> "In our opinion it is an exceedingly doubtful theory that reacquired stock such as is involved here is to be treated as 'property' in the way that stock of another corporation held in a corporation's assets is property. Unless it can be held that the stock which was distributed to petitioner was 'property', as in the latter instance, we cannot hold that the petitioner realized 'income' upon receipt of the stock in question. To whatever extent article 27(c)-1 of Regulations 94 is appropriately applicable here, it must be concluded that the stock dividend in question was not paid in 'property' of the corporation." (239-40)

The Commissioner appealed to the Circuit Court of Appeals for the Second Circuit but dismissed his appeal on July 13, 1943, and acquiesced in the decision, 1943, C.B. 4; and in *T.D. 5290,* 1943 C.B. 366, the Treasury provided that a distribution of stock which would otherwise be non-taxable should not be treated

differently "merely because such distribution was made out of treasury stock."

(*b*) *Redemption for treasury equivalent to a dividend.*

The status of "treasury stock" has been actively considered by the courts in respect to another aspect of tax law in which the Government position has differed from that taken here. Section 115(g) provided that if a corporation "cancels or redeems" its stock, at such time or in such manner as to make the cancellation or redemption essentially equivalent to the distribution of a taxable dividend, it should be taxed as a dividend. The Government position has been that it makes no difference that the stock is held in the treasury and is not actually legally cancelled and retired, that the substance of the transaction is the purchase by the corporation, and the Courts have agreed. *Robinson* v. *Commissioner*, 69 F. (2d) 972; *Kirschenbaum* v. *Commissioner*, 155 F. (2d) 23; *Wall* v. *United States*, 164 F. (2d) 462.

In *Wall* v. *United States*, 164 F. (2d) 462, 465, the Court of Appeals said:

> "The taxpayer also contends that the statute does not fit his case because the Coleman stock was neither cancelled nor redeemed but kept alive in the company's treasury so that, if need be, it could be reissued. The proper method of treating or accounting for the stock of a corporation purchased by it and kept in its treasury has been the subject of much discussion; but it is clear that for tax purposes, the question whether such stock may be regarded as redeemed should be solved by an examination of the attendant circumstances. R.J. Reynolds Tobacco Co. v. Commissioner, 4 Cir., 97 F. 2d 302. As a practical matter, such shares are

redeemed in the sense that they no longer constitute any liability of the corporation but represent nothing more than an opportunity to acquire new assets by a reissuance. Borg v. International Silver Co., 2 Cir., 11 F. 2d 147, 150. We have no difficulty in reaching the conclusion in this case that the shares were redeemed in the statutory sense. They were purchased from Wall who was in effect the sole stockholder of the corporation to relieve him of his obligations to Coleman, and when they were acquired by the corporation, they ceased to have any present significance or vitality. In the words of the statute the distribution and redemption were essentially equivalent to the distribution of a taxable dividend. If it should be held that taxpayers can avoid the terms of the statute by the simple device of selling their stock to the corporation and having it held as treasury stock, the purpose of the statute to prevent the evasion of taxes upon corporate dividends would be completely frustrated."

Treasury Regulation 111 Sec. 29.115-9; rather like those here involved but not so emphatically, provided that the question whether a distribution in connection with the cancellation or redemption of stock is essentially equivalent to the distribution of a taxable dividend depends "upon the circumstances of each case".

The courts have reached their conclusions "upon the circumstances of each case" and their conclusions have varied with the circumstances, but none of them have regarded the fact that the stock was retained in the treasury to be of controlling importance. *Keefe* v. *Cote*, 213 F. (2d) 651; *Zenz* v. *Quinlivan*, 213 F. (2d) 914; *Boyle* v. *Commisisoner*, 187 F. (2d) 557; *Commissioner* v. *Snite*, 177 F. (2d) 819.

In the *Snite* case last cited the Court of Appeals for the Seventh Circuit said:

> "The Tax Court disposed of these citations by the following remarks: 'Respondent insists it is now established law that the net effect of the transaction, rather than the motives and purposes of the corporation or its stockholders, is the test of taxability. It must be recognized that the net effect rationale inheres in a number of decisions. See *Bazley* v. *Commissioner*, 331 U.S. 737 (67 S. Ct. 1489, 91 L. Ed. 1782, 173 A.L.R. 905); *Hirsch* v. *Commissioner* (9 Cir.), 124 F. 2d 24; *Flanagan* v. *Helvering*, (73 App. D.C. 46), 116 F. 2d 937; *Hyman* v. *Helvering* (63 App. D.C. 221), 71 F. 2d 342; cf. *Commissioner* (of Internal Revenue) v. *Bedford's Estate*, 325 U.S. 283 (65 S. Ct. 1157, 89 L. Ed. 1611). But all that this means is that no one factor is controlling. It surely does not mean that the mere existence of sufficient earnings and profits to cover the acquisition of the stock automatically brings the transaction within the provisions of Section 115(g). If that were so, it would seem that practically no room would be left for the operation of the provisions of Section 115(g) relating to distributions in partial liquidation. Just as the presence of a legitimate business purpose will not, standing alone, conclusivel determine that Section 115(g) is inapplicable, so the mere fact that the corporation has sufficient surplus available does not conclusively determine that the section is applicable. All relevant factors must be considered in determining the net effect of the transaction.' With this language we agree. As Judge Vinson, now Chief Justice, said in *Flanagan* v. *Helvering*, 73 App. D.C. 46, 116 F. 2d 937, 939: 'The phrases 'in such manner' and 'essentially equivalent' negative any idea that a weighted formula can resolve the one crucial issue —shall the distribution be treated as a taxable dividend.' And the Treasury Regulations, 111,

Sec. 29, 115-9, themselves provide that whether a distribution in connection with a cancellation or redemption of stock is essentially equivalent to the distribution of a taxable dividend depends upon the circumstances of each case. It seems to us that the court below rightfully decided that, in determining whether the distribution made to the taxpayer was essentially of the character of a dividend, all the factors and all the circumstances should be considered and the net result determined therefrom."

(c) Treasury stock eliminated from invested capital.

The Treasury's approach to another problem involving the acquisition and disposition of its own stock by a corporation has been more realistic. Under the excess profits tax effective in World War I, the purchase of its own stock effected a reduction of the invested capital of a corporation and its sale effected an increase. *Fairmont & Cleveland Coal Co.*, 12 B.T.A. 1296; *Johnson & Co., Inc. v. Noel*, 25 F. (2d) 670.

In Regulations 130 issued under the more recent excess profits tax act, the Treasury ruled:

"Reg. 130, Sec. 40.458-5. (e) The purchase by a corporation of its own stock for investment does not of itself result in a reduction of equity invested capital. But see section 40.440-1 relative to inadmissible assets. If, however, the corporation subsequently cancels such stock, equity invested capital is reduced, beginning with the day following such cancellation, by so much of the adjusted basis of such stock in the hands of the corporation as is not properly chargeable to earnings and profits of the taxable year. If stock is purchased for retirement, there is a distribution on the date of purchase of the amount paid therefor and the equity invested capital is reduced by the amount

thereof not properly chargeable to earnings and profits of the taxable year."

Unless the stockholder could prove that the stock was reacquired for "investment", the purchase price was deducted from invested capital. Under Regulations 112, Section 35.718-5, the Tax Court said in *Christman Co.* v. *Commissioner*, 8 T.C. 679, 688, affirmed 166 F. (2d) 1016:

> "The reacquisition of each share had the effect of distributing $10 of capital, the payment out of what had originally been paid in, and there would be no sound reason for regarding that money, no longer at risk in the business, as a part of equity invested capital."

In the same case, p. 688, the Tax Court expressly stated:

> "The provisions of section 720 and of Regulations 112, section 25.720-1, relating to inadmissible assets, have been considered, but they do not complicate the present issue. The stock presently under consideration was not an asset of the petitioner during the taxable years (*Borg* v. *International Silver Co.*, 11 Fed. (2d) 147; *David Bruckheimer, supra*), and is not within section 720."

That the word "investment" is an important qualification is indicated by the Court in the following statement from *La Belle Iron Works* v. *United States*, 256 U.S. 377, 388:

> "* * * The word 'invested' in itself imports a restrictive qualification. When speaking of the capital of a business corporation or partnership, such as the act deals with, 'to invest' imports a laying out of money, or money's worth, either by

an individual in acquiring an interest in the concern with a view to obtaining income or profit from the conduct of its business, or by the concern itself in acquiring something of permanent use in the business; in either case involving a conversion of wealth from one form into another, suitable for employment in the making of the hoped-for gains."

So in each of these fields the courts have, at times with Treasury assistance and at times despite Treasury opposition, recognized the substantial indistinguishability of treasury and unissued shares. In their approach to the questions, moreover, the courts have required consideration of all relevant factors including the view or purpose underlying the transaction.

CONCLUSION

The decision of the Court of Claims, after consideration of all the undisputed facts and circumstances, that taxpayer did not deal in its own stock as it might the stock of another corporation and that the real nature of the transaction involved was such that it was not brought within the scope of Section 22(a) by the Treasury Regulations is correct. Its judgment should be affirmed.

Respectfully submitted,

JOHN C. WHITE,
Counsel for Respondent

FULBRIGHT, CROOKER, FREEMAN, BATES & WHITE
Of Counsel

September, 1955.